



FINAL DECISION
Endeavour Energy
Distribution Determination

2019 to 2024

Attachment 7
Corporate income tax

April 2019

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Note

This attachment forms part of the AER's final decision on the distribution determination that will apply to Endeavour Energy for the 2019–2024 regulatory control period. It should be read with all other parts of the final decision.

As a number of issues were settled at the draft decision stage or required only minor updates, we have not prepared all attachments. The attachments have been numbered consistently with the equivalent attachments to our longer draft decision. In these circumstances, our draft decision reasons form part of this final decision.

The final decision includes the following attachments:

Overview

Attachment 1 – Annual revenue requirement

Attachment 2 – Regulatory asset base

Attachment 4 – Regulatory depreciation

Attachment 5 – Capital expenditure

Attachment 6 – Operating expenditure

Attachment 7 – Corporate income tax

Attachment 9 – Capital expenditure sharing scheme

Attachment 10 – Service target performance incentive scheme

Attachment 12 – Classification of services

Attachment 13 – Control mechanisms

Attachment 15 – Alternative control services

Attachment 18 – Tariff structure statement

Attachment A – Negotiating framework

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Shortened forms

Shortened form	Extended form
AER	Australian Energy Regulator
ATO	Australian Taxation Office
capex	capital expenditure
CESS	capital expenditure sharing scheme
disposals	asset disposals
distributor	distribution network service provider
DMIAM	demand management innovation allowance mechanism
DV	diminishing value
EBSS	efficiency benefit sharing scheme
Gamma	value of imputation credits
ITAA	Income Tax Assessment Act 1997
NER	National Electricity Rules
opex	operating expenditure
PTRM	post-tax revenue model
RAB	regulatory asset base
RFM	roll forward model
RIN	regulatory information notice
SL	straight-line method for calculating depreciation
TAB	tax asset base
Tax review	The 2018 review of the regulatory tax approach

7 Corporate income tax

Our determination of the annual revenue requirement includes the estimated cost of corporate income tax for Endeavour Energy's (Endeavour) 2019–24 regulatory control period.¹ Under the post-tax framework, a corporate income tax allowance is calculated as part of the building block assessment using our post-tax revenue model (PTRM). This attachment sets out our final decision on Endeavour's revised proposed corporate income tax allowance for the 2019–24 regulatory control period. It presents our assessment of the inputs required in the PTRM for the calculation of the cost of corporate income tax.

7.1 Final decision

Our final decision on the estimated cost of corporate income tax is \$134.7 million for Endeavour over the 2019–24 regulatory control period. This represents a reduction of \$25.2 million (or 15.7 per cent) from Endeavour's revised proposed cost of corporate income tax allowance of \$159.9 million (\$nominal).

The key reasons for this reduction are:

- we amended the PTRM to implement the findings in our final report on the review of the regulatory tax approach (the tax review), which concluded shortly before the submission of Endeavour's revised proposal (section 7.4.1). Specifically, for this final decision, we have applied the diminishing value (DV) method for tax depreciation to all new depreciable assets except for forecast capex associated with in-house software, equity raising costs and buildings. These changes have reduced the revised proposed corporate income tax allowance by about \$14.5 million (or 9.1 per cent).
- we reduced Endeavour's revised proposed return on equity (section 2.2 of the Overview). Our final decision on the forecast return on equity affects the amount of estimated taxable income. Therefore, it has contributed to the reduction on the revised proposed corporate income tax allowance by about \$11.3 million (or 7.0 per cent).

For this final decision, we accept Endeavour's revised proposed:

- opening tax asset base (TAB) value of \$5880.3 million as at 1 July 2019 (section 7.4.2).
- standard and remaining tax asset lives as at 1 July 2019 for the existing asset classes, subject to an aggregation of the land and easement asset classes.² We also determine standard tax asset lives of 5 years for the new '2019-20 to 2023-2024 In-house software' and 40 years for the new '2019-20 to 2023-2024

¹ NER, cl. 6.4.3(a)(4).

² We have also corrected a remaining tax asset life input error in Endeavour's revised proposed PTRM.

Buildings (system)' asset classes. These new asset classes are to be depreciated using the straight-line (SL) method of tax depreciation (sections 7.4.3 and 7.4.4).

- value of imputation credits (gamma) of 0.585 (section 2.2 of the Overview).

Our final decision on regulatory depreciation (attachment 4) also affects the calculation of the estimated taxable income, which in turn impacts the corporate income tax allowance.

Table 7.1 sets out our final decision on the estimated cost of corporate income tax allowance for Endeavour over the 2019–24 regulatory control period.

Table 7.1 AER's final decision on Endeavour's cost of corporate income tax allowance for the 2019–24 regulatory control period (\$million, nominal)

	2019–20	2020–21	2021–22	2022–23	2023–24	Total
Tax payable	65.3	58.8	66.2	69.5	64.8	324.6
Less: value of imputation credits	38.2	34.4	38.7	40.7	37.9	189.9
Net corporate income tax allowance	27.1	24.4	27.5	28.9	26.9	134.7

Source: AER analysis.

7.2 Endeavour Energy's revised proposal

Endeavour's revised proposed corporate income tax allowance is \$159.9 million for the 2019–24 regulatory control period. Endeavour's revised proposal is based on the approach in the draft decision to estimate the corporate income tax allowance. In its revised proposal, Endeavour noted the AER's tax review and the potential impact on its corporate income tax allowance.³

Table 7.2 sets out Endeavour's revised proposed roll forward of its TAB values over the 2014–19 regulatory control period.

Table 7.3 sets out Endeavour's revised proposed corporate income tax allowance for the 2019–24 regulatory control period.

³ Endeavour, *Revised regulatory proposal*, January 2019, p. 31.

Table 7.2 Endeavour’s revised proposed TAB roll forward (\$million, nominal)

	2014–15	2015–16	2016–17	2017–18	2018–19
Opening TAB	4572.9	4895.0	5058.4	5243.7	5567.7
Capital expenditure ^b	477.1	334.2	354.3	503.1	514.3
Less: tax depreciation	155.0	170.8	169.0	179.1	201.7
Closing TAB	4895.0	5058.4	5243.7	5567.7	5880.3

Source: Endeavour, *0.04 Revised Roll Forward Model*, January 2019.

(a) Based on estimated capex.

(b) Net of disposals.

Table 7.3 Endeavour’s revised proposal cost of corporate income tax allowance for the 2019–24 regulatory control period (\$million, nominal)

	2019–20	2020–21	2021–22	2022–23	2023–24	Total
Tax payable	70.0	68.0	79.1	85.1	83.1	385.3
Less: value of imputation credits	40.9	39.8	46.3	49.8	48.6	225.4
Net corporate income tax allowance	29.0	28.2	32.8	35.3	34.5	159.9

Source: Endeavour, *0.03 Revised Post-Tax Revenue Model*, January 2019.

7.3 Assessment approach

We make an estimate of taxable income for each regulatory year as part of our determination of the annual revenue requirement for Endeavour’s 2019–24 regulatory control period.⁴ Our estimate is the taxable income a benchmark efficient entity would earn for providing standard control services if it operated Endeavour’s network business.

For this final decision, we have changed some aspects of our approach for calculating the estimated corporate income tax allowance since we made the draft decision in November 2018. In our draft decision, we noted that we had commenced a review into our regulatory tax approach. We also noted that we would apply any changes to our regulatory models arising from the tax review to the final decision for Endeavour’s 2019–24 regulatory control period.

In December 2018, we released the final report of the tax review,⁵ which identified some required changes to our approach to estimating tax depreciation expenses in our

⁴ NER, cl. 6.5.3.

⁵ AER, *Final report: Review of regulatory tax approach*, December 2018, p. 76.

regulatory models (PTRM and RFM).⁶ The changes to our regulatory tax approach require amending our models to:⁷

- recognise immediate tax expensing of some capex forecast for a regulatory control period
- adopt the DV method for tax depreciation to all future capex except for a limited number of assets which must be depreciated using the SL depreciation method under the tax law.

In April 2019, we published a new version of the PTRM (version 4) which implements the changes to the tax depreciation approach. We have not yet amended the RFM because the tax review final report stated that the required changes to the tax depreciation approach would apply to new assets only. This means that only changes to the PTRM are required in the first regulatory control period when transitioning into the new tax approach. As such, the tax depreciation approach in the RFM remains the same as the draft decision for the purposes of this final decision.

How the estimated cost of corporate income tax is calculated in the PTRM

Our approach for calculating a distributor's estimated cost of corporate income tax allowance is set out in our PTRM⁸ and involves the following steps:⁹

1. We estimate the annual assessable income (taxable revenue) that would be earned by a benchmark efficient entity operating the distributor's business. This is the approved forecast revenues for the distribution business that we determined using the building block approach.¹⁰
2. We then estimate the benchmark tax expenses such as operating expenditure (opex), interest expense, tax depreciation in the following ways:
 - Operating expense is set equal to the opex building block.¹¹
 - Interest expense is a function of the size of the regulatory asset base (RAB), the benchmark gearing assumption (60 per cent) and the regulated cost of debt.
 - Tax depreciation expense is calculated using a separate value for the TAB, and standard and remaining tax asset lives for taxation purposes.

⁶ The PTRM specifies the manner in which the estimated cost of corporate income tax is to be calculated. The RFM calculates the distributor's tax asset base which is an input to the PTRM for the calculation of the tax building block.

⁷ Capping of gas asset tax lives was also a finding from the final report, but does not require a model change.

⁸ AER, *Distribution PTRM (version 4)*, April 2019.

⁹ The PTRM must specify the manner in which the estimated cost of corporate income tax is to be calculated: NER, cl. 6.4.2(b)(4).

¹⁰ The total revenue for tax purposes is the sum of the building blocks including return on capital, return of capital, operating expenditure and cost of corporate taxation, and any capital contributions. It may also include revenue increments or decrements generated from capital expenditure sharing scheme (CESS), efficiency benefit sharing scheme (EBSS) and demand management innovation mechanism (DMIAM).

¹¹ Our assessment approach for the opex building block is discussed in attachment 6.

Previously, the PTRM applied the SL method for calculating tax depreciation for all assets. Consistent with the findings of the tax review, the new amended PTRM (version 4) applies the SL method for calculating tax depreciation for existing assets and the DV method¹² for all new assets except for in-house software, buildings and equity raising costs. The expenditure for these assets are to be depreciated using the SL method under the tax law. The new amended PTRM (version 4) also accounts for the value of certain forecast capex to be immediately expensed when estimating the benchmark tax expense. The value of immediately expensed capex is deducted from the net capex to be depreciated for tax purposes for the year in which it is forecast to be incurred,¹³ and is then included in the total tax depreciation amount for that year.

Revenue increments or decrements generated from CESS, EBSS and DMIAM may also be included in the benchmark tax expenses if they are also included in the taxable revenue.

3. We estimate the annual taxable income that would be earned by a benchmark efficient entity operating the distributor's business by subtracting the benchmark estimates of tax expenses (step 2) from the approved forecast revenues for the distribution business (step 1).
4. We apply the statutory income tax rate to the estimated annual taxable income (after adjustment for any tax loss carried forward) to arrive at a notional amount of tax payable.
5. We deduct the expected value for the utilisation of imputation credits (gamma) by investors from the notional amount of tax payable. The tax payable net of the expected value of imputation credits represents the corporate income tax allowance and is included as a separate building block in determining the distributor's annual revenue requirement.

How we assess the tax inputs to the PTRM

The estimated cost of corporate income tax allowance is an output of our PTRM. We therefore assess the distributor's proposed cost of corporate tax allowance by analysing the proposed inputs to the PTRM for calculating that allowance. While our assessment approach for most of the tax inputs has not changed since the draft decision, we have updated the value of gamma in this final decision to be consistent with the 2018 *Rate of return instrument*. In addition, our amended PTRM (version 4) requires two new set of inputs for the calculation of tax depreciation—the forecast immediate expensing of certain capex and the assets to be exempted from the DV method of tax depreciation.

¹² For more explanation of how we calculate depreciation using the DV method, please see: AER, *Distribution PTRM handbook*, April 2019, p. 22.

¹³ That is, the net capex to be added to the TAB for tax depreciation purposes is the amount of gross capex, less disposals, less the immediately deductible capex.

Our assessment approach for each of the tax inputs required in the PTRM including the two new inputs are discussed in turn below:

- **The opening TAB as at the commencement of the 2019–24 regulatory control period:** We consider that the roll forward of the opening TAB should be based on the approved opening TAB as at 1 July 2014 and Endeavour’s actual capex incurred during the 2014–19 regulatory control period, and the final year (2013–14) of the previous regulatory control period.¹⁴ Our assessment approach for this input has not changed since the draft decision.

The roll forward of the opening TAB for 2014–19 is calculated in our RFM. We have not amended the RFM to implement the tax review. This is because the tax review final report set out that the required changes to the tax depreciation approach would apply to new assets only. As such, the approach for determining the opening TAB value remains the same as the draft decision for the purposes of this final decision. Subsequent to this final decision we will make the relevant amendments to the RFM for changes from the tax review. The amended RFM will then be used for the purposes of the TAB roll forward for 2019–24 at the next reset.

This opening TAB value is used to estimate forecast tax depreciation for the 2019–24 regulatory control period, including new assets to be added to the TAB over this period. We will continue to apply the SL method of tax depreciation for the opening TAB value. However, for all new assets forecast to be added to the TAB in the 2019–24 regulatory control period (with some exceptions discussed further below), we will apply the DV method of tax depreciation.

- **The remaining tax asset life for each asset class at the commencement of the 2019–24 regulatory control period:** Our standard method in the RFM for determining the remaining tax asset lives is the weighted average method. Our assessment approach for this input has not changed since the draft decision.
- **The standard tax asset life for each asset class:** Our assessment of Endeavour's proposed standard tax asset lives is guided by the effective life of depreciating assets determined by the Commissioner for Taxation. We consider that the standard tax asset lives for the majority of Endeavour's asset classes should be consistent with the ATO taxation ruling 2018/4 regarding the effective life of depreciating assets where possible.¹⁵

While our assessment approach for this input has not changed since the draft decision, we also explain how we assess the standard tax asset lives for the in-house software, buildings and equity raising costs asset classes.

As discussed above, the new amended PTRM (version 4) applies the DV tax depreciation method for all new assets except for in-house software, buildings and equity raising costs. It provides designated asset classes for these assets to be

¹⁴ The tax depreciation is therefore recalculated based on actual capex. The same tax depreciation approach of using actual capex applies to the roll forward of the TAB at the next reset.

¹⁵ ATO, *Taxation Ruling 2018/4– Income tax: effective life of depreciating assets (applicable from 1 July 2018)*.

depreciated using the SL method for tax purposes.¹⁶ We note that the tax effective lives for in-house software, buildings and equity raising costs are not covered under the ATO taxation ruling 2018/4. Therefore, our assessment of the standard tax asset lives for these asset classes are guided by the *Income Tax Assessment Act 1997* (ITAA). Specifically, we consider that the standard tax asset life should be:

- 40 years for buildings – This is consistent with the number of years required to completely depreciate a capital works asset such as buildings for tax purposes when applying sections 43.15, 43.140 and 43.210 of the ITAA.
 - 5 years for in-house software – This is consistent with section 40.95(7) of the ITAA.
 - 5 years for equity raising costs – This is consistent with section 40.880 of the ITAA.
- **The income tax rate:** The statutory income tax rate is 30 per cent per year. This is consistent with the rate applied in the draft decision.
 - **The value of gamma:** The gamma input for Endeavour is 0.585 for this final decision. Our draft decision applied a gamma value of 0.5. Since then, we have published the *Rate of return instrument*, which requires us to use a gamma value of 0.585.¹⁷ Refer to section 2.2 of the Overview for further discussion on this matter.
 - **The size and treatment of any tax losses as at 1 July 2019:** Where a business has tax losses, we require the provision of this value to determine the appropriate estimated taxable income for a regulatory control period. If there is an amount of tax losses accumulated, the forecast taxable income for the regulatory control period will be reduced by this amount. Our assessment approach for this input has not changed since the draft decision. Endeavour does not have any accumulated tax losses as at the start of the 2019–24 regulatory control period.¹⁸
 - **Forecast immediate expensing of capex:** The amended PTRM (version 4) requires a forecast for immediately deductible capex to be provided for each regulatory year of the 2019–24 regulatory control period. For this final decision, our assessment of forecast immediate expensing of capex will be guided by the distributor's actual immediate expensing of capex from the previous regulatory control period. We will collect actual data relating to this expenditure in our annual reporting regulatory information notice (RIN) to further inform our decision on the amount of forecast immediate expensing of capex in future regulatory determinations.

¹⁶ Our assessment approach on new assets to be exempted from the DV method is discussed in detail below.

¹⁷ AER, *Rate of return instrument*, December 2018, p. 19.

¹⁸ Endeavour, *0.03 Revised Post-Tax Revenue Model*, January 2019.

- **Diminishing value multiplier:** The amended PTRM (version 4) applies the following formula to calculate the tax depreciation under the DV method:¹⁹

$$D_t = \left(\text{Nominal net capex}_i - \sum_{n=0}^{t-1} D_n \right) \times \text{DV multiplier} \div \text{standard tax asset life}$$

where:

D_t is the tax depreciation in year t

$D_0 = 0$

$t = 1, 2, 3, \dots$

$i = \text{year } 0$

The PTRM provides an input section for the 'DV multiplier' in the above formula to be recorded for each year of the regulatory control period. This is labelled as the 'diminishing value multiplier' in the PTRM. We note that currently the DV multiplier is set at 200 per cent by the ATO. Our assessment approach for the standard tax asset life inputs are discussed above. The assessment approach for capex is discussed in attachment 5.

- **New assets to be exempted from the diminishing value method:** The amended PTRM (version 4) applies the DV method for tax depreciation purposes to all new depreciable assets except for certain assets. It provides for asset classes 47, 48, 49 and 50 to be depreciated using the SL method for tax purposes rather than the DV method. These asset classes are to contain new assets associated with in-house software, buildings and equity raising costs.

We consider that the benchmark allowance for equity raising costs should not be depreciated using the DV method. We note that section 40.880 of the ITAA and the ATO's taxation ruling 2011/6²⁰ require that businesses claim deductions on equity raising costs in equal proportions over a five-year period. Therefore, in the PTRM, we apply the SL method for calculating the tax depreciation for equity raising costs, consistent with the ITAA and ATO's requirements.²¹ Further, the distributor may propose capex associated with buildings and in-house software to be exempted from the DV method of tax depreciation in the PTRM if the proposal satisfies the following requirements:

- **Buildings:** We consider that capex for buildings may be exempted from the DV method in the PTRM, consistent with sections 43.15, 43.140 and 43.210 of the ITAA. However, such capex must be consistent with the definition of a capital work under section 43.20 of the ITAA and in ATO taxation ruling

¹⁹ This formula shows how the tax depreciation for capex in a particular year is calculated under the DV method in the PTRM.

²⁰ ATO, *Taxation Ruling 2011/6*, July 2016.

²¹ The benchmark allowance for equity raising costs is determined within the PTRM.

97/25.²² We note that this includes new buildings and structural improvements to existing buildings.²³ However, capex on separate assets within a building such as air-conditioning units, transformers and converters are not consistent with the definition of a capital work, and therefore are required to be depreciated using the DV method in the PTRM.

- **In-house software:** We consider that capex for in-house software may be exempted from the DV method in the PTRM, consistent with section 40.72 of the ITAA. However, such capex must be consistent with the definition of in-house software under section 995.1 of the ITAA and in ATO taxation ruling 2016/3.²⁴ We note that this includes computer software, or the right to use computer software that the distributor acquires, develops or has someone else develop for the distributor's business use.²⁵ However, capex associated with other IT assets such as computer hardware is not consistent with the definition of in-house software, and therefore is required to be depreciated using the DV method in the PTRM.

7.4 Reasons for final decision

We determine a cost of corporate income tax allowance of \$134.7 million (\$nominal) for Endeavour over the 2019–24 regulatory control period. This represents a reduction of \$25.2 million (or 15.7 per cent) compared to Endeavour's revised proposal.

As discussed above, we applied the new amended PTRM (version 4) for this final decision to implement the changes to our regulatory tax approach identified in the tax review final report. These changes have reduced the revised proposed cost of corporate income tax allowance by about \$14.5 million (or 9.1 per cent).

We accept the revised proposed opening TAB as at 1 July 2019 of \$5880.3 million (\$nominal). We also accept the revised proposed standard and remaining tax asset lives as at 1 July 2019 for the existing asset classes, subject to an aggregation of the land and easement asset classes. We determine standard tax asset lives of 5 years for the new '2019-20 to 2023-24 In-house software' and 40 years for the new '2019-20 to 2023-24 Buildings (system)' asset classes. These new asset classes are to subject to the SL method of tax depreciation. The reasons for our final decision are discussed below.

Discussed in other attachments and the Overview, our final decision on Endeavour's revised proposed return on capital (attachments 2, 5, and section 2.2 of the Overview) and the regulatory depreciation (attachments 4) building blocks affect total revenues, and therefore also impact the forecast corporate income tax allowance. We have accepted the revised proposed value of imputation credits (gamma) of 0.585 (section 2.2 of the Overview).

²² ATO, *Taxation Ruling 97/25*, July 2017.

²³ ITAA, section 43.20.

²⁴ ATO, *Taxation Ruling 2016/3*, October 2018.

²⁵ ITAA, section 995.1.

7.4.1 Implementation of the tax review

In the draft decision, we applied the existing PTRM (version 3) at the time to calculate the various components required to estimate Endeavour's cost of corporate income tax for the 2019–24 regulatory control period. We noted that we would apply any amended regulatory models arising from the tax review for the final decision. Endeavour calculated the corporate income tax allowance using version 3 of our PTRM for its revised proposal, which was submitted prior to the finalisation of the new PTRM version 4.

We published the new amended PTRM (version 4) in April 2019 which implements the changes identified from the final report of the tax review.²⁶ Specifically, we made the following two changes which affect the calculation of tax depreciation in the PTRM:

- **Immediate expensing of capex** – we allow for certain capex to be immediately expensed when estimating the benchmark tax expense.
- **Diminishing value depreciation method** – we apply the DV method for tax depreciation purposes to all new depreciable assets except for capex associated with in-house software, equity raising costs and buildings.²⁷

We consulted with Endeavour on the PTRM changes and the required new inputs for implementing the new tax depreciation approach following the completion of the tax review. While Endeavour was not required to provide these inputs as part of its revised regulatory proposal, it has actively engaged with us in the lead up to this final decision in order to provide the relevant tax input requirements of the amended PTRM.

Our assessment of the new tax inputs submitted by Endeavour are discussed below.

Forecast immediate expensing of capex

Certain capex (such as refurbishment capex) is able to be 'immediately expensed' under tax legislation. The amended PTRM (version 4) requires a forecast for immediately deductible capex to be provided for each asset class for each regulatory year of the 2019–24 regulatory control period.

Endeavour submitted that it has not forecast any of its capex as immediately deductible during the 2019–24 regulatory control period.²⁸ For this final decision, we accept Endeavour's submission because the proposed approach is consistent with its past tax practice. As discussed above, we will collect actual data relating to this expenditure in our annual reporting RINs to further inform our decision on the amount

²⁶ We have not yet amended the RFM to implement the new tax depreciation approach. This is because the final report of the tax review recommended that the required changes would apply to new assets only. This means that only changes to the PTRM are required in the first regulatory control period when transitioning into the new tax depreciation approach.

²⁷ The buildings asset class may be classified as system or non-system assets in the PTRM.

²⁸ Endeavour, *Response to AER email: Implementation of the tax review - Endeavour*, dated 18 January 2019.

of forecast immediate expensing of capex in the next regulatory determination for Endeavour.

Assets exempt from the diminishing value method

In our draft decision, we used version 3 of the PTRM which applies the SL method to calculate tax depreciation for all asset classes. The amended PTRM (version 4) continues to apply the SL tax depreciation method to the opening TAB at 1 July 2019, but applies the DV method as the new regulatory benchmark for tax depreciation to all new capex.²⁹ However, as discussed above, there are some exceptions to this approach under the tax law such as assets relating to in-house software, buildings and equity raising costs.³⁰ In the PTRM, the benchmark allowance for equity raising costs is determined within the model and depreciated using the SL tax depreciation method as default. As part of our consultation on the new inputs for Endeavour's forecast capex, we asked Endeavour if it wishes to propose any relevant forecast capex to be exempted from the DV tax depreciation method.

In its response to our information request, Endeavour submitted that \$70.3 million (\$2018–19) of forecast capex associated with buildings (system and non-system) and \$75.3 million of forecast capex associated with in-house software are to be exempted from the DV tax depreciation method.³¹ It has provided us with the reallocation of the forecast capex related to these assets from certain existing asset classes to the prescribed SL tax depreciation asset classes in the PTRM. Specifically, these reallocations are:

- A proportion of forecast capex in the '2019-20 to 2023-24 Substations' asset class is reallocated to the new '2019-20 to 2023-24 Buildings (system)' asset class.
- Forecast capex in the '2019-20 to 2023-24 Buildings' asset class is fully reallocated to the relabelled '2019-20 to 2023-24 Buildings (non-system)' asset class.
- A proportion of forecast capex in the '2019-20 to 2023-24 Information & communication technology' asset class is reallocated to the new '2019-20 to 2023-24 In-house software' asset class.

We accept Endeavour's proposed allocation of forecast capex for buildings and in-house software to be depreciated using the SL method for tax depreciation purposes. This is because the proposed forecast capex for:

- buildings satisfies the definition of a capital work under section 43.20 of the ITAA and in ATO taxation ruling 97/25³²
- in-house software satisfies the definition under section 995.1 of the ITAA and ATO taxation ruling 2016/3.³³

²⁹ AER, *Final report: Review of regulatory tax approach*, December 2018, p. 76.

³⁰ Asset classes 47, 48, 49 and 50 in the PTRM (version 4) provide for this.

³¹ Endeavour, *Response to AER email: Implementation of the tax review - Endeavour*, dated 15 February 2019.

³² ATO, *Taxation Ruling 97/25*, July 2017.

Therefore, these assets are not required to be depreciated using the DV method for tax purposes. The overall impact of our final decision to apply the DV tax depreciation method to new assets is to reduce Endeavour's revised proposed estimated corporate income tax allowance by about \$14.5 million (\$nominal, or 9.1 per cent), all else being equal.

7.4.2 Opening tax asset base as at 1 July 2019

For this final decision, we accept Endeavour's proposed opening TAB value as at 1 July 2019 of \$5880.3 million (\$nominal). Table 7.2 sets out the roll forward of Endeavour's TAB values over the 2014–19 regulatory control period.

In our draft decision, we accepted Endeavour's proposed method to establish the opening TAB as at 1 July 2019. We also accepted the proposed opening TAB value and noted that this opening TAB as at 1 July 2019 may be updated to reflect actual capex for 2017–18 and any revised 2018–19 capex estimates as part of the final decision.

In its revised proposal, Endeavour has adopted the same approach from the draft decision on the establishment of an opening TAB as at 1 July 2019. It has updated the 2017–18 capex with actuals and retained the 2018–19 capex estimates.³⁴ Endeavour's revised proposed opening TAB value is \$24.7 million higher than the value we determined in the draft decision. For the reasons discussed in attachment 2, we accept the 2017–18 actual capex in the revised proposal. We also accept the 2018–19 estimate of capex, and we will update this for actuals at the next revenue reset.

7.4.3 Standard tax asset lives

For this final decision, we accept Endeavour's revised proposed standard tax asset lives for its existing asset classes subject to an aggregation of the land and easement asset classes. In addition, we determine standard tax asset lives of 40 years and 5 years for the new '2019-20 to 2023-24 Buildings (system)'³⁵ and '2019-20 to 2023-24 In-house software' asset classes.

In the draft decision, we accepted Endeavour's proposed standard tax asset lives. Endeavour's revised proposal adopted the draft decision standard tax asset lives.

Discussed in section 7.4.1, as part of the implementation of the new tax depreciation approach, Endeavour proposed to reallocate forecast capex associated with buildings and in-house software into the prescribed SL tax depreciation asset classes in the amended PTRM. The existing asset class for '2019-20 to 2023-24 Buildings' has been moved to apply the SL tax depreciation method—relabelled '2019-20 to 2023-24

³³ ATO, *Taxation Ruling 2016/3*, October 2018.

³⁴ Endeavour, *0.04 Revised Roll Forward Model*, January 2019.

³⁵ Endeavour has an existing '2019-20 to 2023-24 Buildings' asset class which has been relabelled to '2019-20 to 2023-24 Buildings (non-system)' and retains the same standard tax asset life of 40 years.

Buildings (non-system)—and so we retain a standard tax asset life of 40 years for this asset class that is consistent with our draft decision. We determine a standard tax asset life of 40 years for the new ‘2019-20 to 2023-24 Buildings (system)’ asset class, as this is consistent with the number of years required to completely depreciate a capital works asset for tax purposes under the ITAA.³⁶ We also determine a standard tax asset life of 5 years for the new ‘2019-20 to 2023-24 In-house software’ asset class, as this is consistent with the ITAA.³⁷ In its response to our information request, Endeavour agreed that both of these standard tax asset lives are appropriate for the new asset classes for tax depreciation purposes.³⁸

Our final decision also amends Endeavour’s revised proposal PTRM by aggregating the various asset classes which relate to land and easements into a single asset class labelled as ‘Land and easements’. Land and easements are non-depreciating assets and therefore do not need to be disaggregated for the period-by-period tracking depreciation approach.

Table 7.4 sets out our final decision on the standard tax asset lives for Endeavour. We are satisfied that the standard tax asset lives are appropriate for application over the 2019–24 regulatory control period. We are also satisfied the standard tax asset lives provide an appropriate estimate of the tax depreciation amount that would be consistent with the tax expenses used to estimate the annual taxable income for a benchmark efficient service provider.³⁹

³⁶ ITAA, sections 43.15, 43.140, 43.210.

³⁷ ITAA, section 40.95(7).

³⁸ Endeavour, *Response to AER email: Implementation of the tax review - Endeavour*, dated 6 March 2019.

³⁹ NER, cl. 6.5.3.

Table 7.4 AER’s final decision on Endeavour’s standard tax asset lives for the 2019–24 regulatory control period (years)

Asset class	Standard tax asset life
Land & easements	n/a
2019-20 to 2023-24 Sub-transmission lines and cables	46.8 ^a
2019-20 to 2023-24 Distribution lines and cables	47.9 ^a
2019-20 to 2023-24 Substations	40.0 ^a
2019-20 to 2023-24 Transformers	40.0 ^a
2019-20 to 2023-24 Low voltage lines and cables	47.8 ^a
2019-20 to 2023-24 Customer metering and load control	25.0 ^a
2019-20 to 2023-24 Communication	10.0 ^a
2019-20 to 2023-24 Emergency spares (major plant, excludes inventory)	40.0 ^a
2019-20 to 2023-24 Information & communication technology	4.9 ^a
2019-20 to 2023-24 Furniture, fittings, plant and equipment	7.2 ^a
2019-20 to 2023-24 Motor vehicles	12.1 ^a
2019-20 to 2023-24 Buildings (system)	40.0 ^b
2019-20 to 2023-24 Buildings (non-system)	40.0 ^b
2019-20 to 2023-24 In-house software	5.0 ^b
2019-20 to 2023-24 Equity raising costs	5.0 ^b

Source: AER analysis.

(a) Used for diminishing method of tax depreciation.

(b) Used for straight-line method of tax depreciation.

n/a not applicable. We have not assigned a standard tax asset life to the ‘Land & easements’ asset class because the assets allocated to this asset class are non-depreciating assets.

7.4.4 Remaining tax asset lives as at 1 July 2019

For this final decision, we accept Endeavour’s revised proposed remaining tax asset lives as at 1 July 2019 for tax depreciation purposes of its existing assets. These were calculated using the weighted average method, which is consistent with the approach accepted in our draft decision.

In the draft decision, we accepted Endeavour’s proposal to create separate asset classes for each regulatory control period (period-by-period tracking approach) to provide more accurate treatment of depreciation associated with capex forecast for that period. Consequently, we also accepted Endeavour’s proposal to use the RFM’s weighted average remaining life approach to determine the remaining tax asset lives as at 1 July 2019 for its existing asset classes. A new set of asset classes is then applied for depreciating new capex over the 2019–24 regulatory control period

Endeavour's revised proposal has adopted the same approach that we accepted in the draft decision. It has updated the remaining tax asset lives to reflect the revised opening TAB value.

For the new '2019-20 to 2023-24 In-house software' and '2019-20 to 2023-24 Buildings (system)' asset classes we have not assigned remaining tax asset lives as there are no opening tax values for these asset classes, only forecast capex are being allocated to these asset classes over the 2019–24 regulatory control period. We therefore record 'n/a' in the PTRM for these asset classes.

As discussed above, we have aggregated the various asset classes which relate to land and easements into a single asset class labelled as 'Land and easements'. For this final decision, we have not assigned a remaining tax asset life for the newly aggregated 'Land and easement' asset class as these assets are non-depreciating. We therefore record 'n/a' in the PTRM for this asset class. We have also corrected an input error in Endeavour's revised proposed PTRM relating to the remaining tax asset life for the '2014-15 to 2018-19 Land' asset class. This input error has been removed in the final decision PTRM as a result of aggregating the land and easements asset classes.

Table 7.5 sets out our final decision on the remaining tax asset lives as at 1 July 2019 for Endeavour. We consider the remaining tax asset lives are appropriate for application over the 2019–24 regulatory control period. We are satisfied the remaining tax asset lives provide an appropriate estimate of the tax depreciation amount that would be consistent with the tax expenses used to estimate the annual taxable income for a benchmark efficient service provider.⁴⁰

⁴⁰ NER, cl. 6.5.3.

Table 7.5 AER’s final decision on Endeavour’s remaining tax asset lives as at 1 July 2019 (years)

Asset class	Remaining tax asset life ^a
Land & easements	n/a
2013-14 ORAB Sub-transmission lines and cables	33.0
2013-14 ORAB Distribution lines and cables	34.0
2013-14 ORAB Substations	28.8
2013-14 ORAB Transformers	22.5
2013-14 ORAB Low voltage lines and cables	29.5
2013-14 ORAB Customer metering and load control	13.0
2013-14 ORAB Communication	3.3
2013-14 ORAB Equity raising costs	32.0
2013-14 ORAB Emergency spares (major plant, excludes inventory)	21.9
2013-14 ORAB Information & communication technology	0.0
2013-14 ORAB Furniture, fittings, plant and equipment	5.0
2013-14 ORAB Motor vehicles	2.1
2013-14 ORAB Buildings	28.3
2013-14 ORAB Other non-system assets	n/a
2014-15 to 2018-19 Sub-transmission lines and cables	44.6
2014-15 to 2018-19 Distribution lines and cables	46.1
2014-15 to 2018-19 Substations	38.1
2014-15 to 2018-19 Transformers	37.8
2014-15 to 2018-19 Low voltage lines and cables	45.8
2014-15 to 2018-19 Customer metering and load control	23.1
2014-15 to 2018-19 Communication	8.9
2014-15 to 2018-19 Equity raising costs	1.0
2014-15 to 2018-19 Emergency spares (major plant, excludes inventory)	39.1
2014-15 to 2018-19 Information & communication technology	2.4
2014-15 to 2018-19 Furniture, fittings, plant and equipment	7.3
2014-15 to 2018-19 Motor vehicles	11.3
2014-15 to 2018-19 Buildings	37.2

Source: AER analysis.

(a) Used for straight-line method of tax depreciation.

n/a not applicable. We have not assigned a remaining tax asset life to the 'Land & easements' asset class because the assets allocated to this asset class are non-depreciating assets. We have not assigned a remaining tax asset life to the '2013-14 ORAB Other non-system assets' asset class because there is no opening TAB value as at 1 July 2019 for this asset class.